

Members

Sen. Joseph Harrison, Chairperson  
Sen. R. Michael Young  
Sen. Allie Craycraft  
Sen. Larry Lutz  
Rep. Larry Buell  
Rep. Woody Burton  
Rep. Thomas Kromkowski  
Rep. R. Tiny Adams  
Steve Meno  
Kip White



# PENSION MANAGEMENT OVERSIGHT COMMISSION

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Authority: IC 2-5-12-1

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## MEETING MINUTES<sup>1</sup>

**Meeting Date:** September 14, 2005  
**Meeting Time:** 10:00 A.M.  
**Meeting Place:** State House, 200 W. Washington  
St., Room 431  
**Meeting City:** Indianapolis, Indiana  
**Meeting Number:** 1

**Members Present:** Sen. Joseph Harrison, Chairperson; Sen. R. Michael Young;  
Sen. Allie Craycraft; Sen. Larry Lutz; Rep. Larry Buell; Rep.  
Woody Burton; Rep. Thomas Kromkowski; Rep. R. Tiny Adams;  
Steve Meno; Kip White.

**Members Absent:** None.

Senator Joseph Harrison, chair of the Pension Management Oversight Commission (the Commission), called the meeting to order at 10:00 a.m. He called on staff to outline the study topics assigned to the Commission by the Legislative Council.

### 1. Study Topics Assigned by the Legislative Council

The Legislative Council assigned three topics to the Commission for study during this interim.

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<sup>1</sup> Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.ai.org/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

(A) Local government pension relief distribution delay (SR 10)

The Commission is to study the possibility of removing the January 1, 2008, expiration date from IC 5-10.3-11-4.7, which addresses distributions from the Pension Relief Fund to units of local government to pay benefits under the 1925 Police Pension Fund, the 1937 Firefighters' Pension Fund, and the 1953 Police Pension Fund (collectively, the Old Funds). IC 5-10.3-11-4.7 requires that annual payments from the Pension Relief Fund to a unit of local government may not be less than half of the total of certain pension payments to be made by the unit in the calendar year.

(B) Repeal of the expiration of the deferred retirement option plan (DROP) (SR 11)

The Commission is to study the possibility of repealing the expiration of the public safety deferred retirement option plan (DROP). IC 36-8-8.5-14, which addresses the timing for members to exit the DROP, is set to expire on January 1, 2008.

(C) Volunteer public safety officers health benefits/presumptions (Unnumbered HR)

The Commission is to examine and make recommendations regarding the extension to police officers and firefighters who are employed full time by the state or a political subdivision of the state and also serve in a volunteer capacity as firefighters, emergency medical technicians, or first responders of the presumption under IC 5-10-13 that, if an individual is diagnosed with certain health conditions, including HIV/AIDS, hepatitis, anthrax, meningococcal meningitis, smallpox, or tuberculosis, that result in disability or death, the individual's disability or death was incurred in the line of duty for purposes of qualification for certain benefits.

Staff reported that Doug Todd of McCready & Keene, the actuaries for the police and fire pension funds, will provide information at the next Commission meeting about the fiscal impact of removing the January 1, 2008, expiration date from IC 5-10.3-11-4.7 (Topic (A)) and repealing the expiration of the public safety deferred retirement option plan (DROP) (Topic (B)).

Matt Brase of the Indiana Association of Cities and Towns (IACT) testified in support of Topics (A) and (B). Pension relief is an important and ongoing issue for IACT's members. IACT does not recommend taking action on Topic (C).

Tom Hanify representing the Indiana Association of Firefighters testified in support of IACT's testimony. He stated that pension relief is a pending problem and should be addressed.

Leo Blackwell representing the Fraternal Order of Police also testified in support of IACT's and Mr. Hanify's testimony. The keystone for police officers is pension relief.

## **2. Presentation by the Public Employees' Retirement Fund (PERF)**

(A) 2005 PERF Update

David Adams, PERF Executive Director, presented PERF's 2005 update (Exhibit 1). He discussed PERF's Mission Statement, which includes a commitment to exceptional customer service. The current market value of the Fund (as to July 1, 2005) is \$12.83 billion. The experience level of the PERF staff is: 27% have less than one year of experience, 62 % have less than three years of experience, and 15% have more than 12

years of experience.

### (1) Investment Policy and Results

Mr. Adams discussed PERF's investment results and policy. Prior to 1996, the entire Fund was invested exclusively in fixed income investments. Following a 1996 amendment to Indiana's Constitution, PERF made its first equity investment, a \$300 million purchase in a Standard & Poore's 500 index fund. Mr. Adams reviewed the Fund's asset allocation history and June 30th market value for each year from 1996 through July 31, 2005.

The current target asset allocations for the Consolidated Retirement Investment Fund (CRIF) are between 42% and 51% for Domestic Equities (actual is 49.5%), between 8% and 17% for International Equities (actual is 13.3%), between 6% and 15% for Global Equities (actual is 8.4%), between 24% and 42% for Fixed Income (actual is 28.1%), between 2% and 11% for Alternatives (actual is 0.3%), and 0% cash (actual is 0.4%). Mr. Adams identified alternatives as an area in which PERF is looking for additional investment.

### (2) Fund Membership

Mr. Adams reviewed PERF's member base. PERF has more than 184,000 active members. The top 5 employers represent 37% of the total. The top employer, the State of Indiana, represents 25% of the total. PERF has more than 1,100 employer participants. The top 25 employers represent 51% of the fund's total membership. Employers with 50 or less employees represent 63% of the fund's total membership.

### (3) Customer Service Initiatives

PERF continues to focus on customer service to its members. PERF conducted a survey of its members to determine what it does well, where it could improve, and which additional services its members would like to see PERF provide.

PERF is addressing the problems listed in last year's State Board of Accounts (SBOA) audit. PERF's first steps have involved monthly account reconciliation. However, because the SBOA did not conduct its audit exit interview with PERF until two months before the end of the fiscal year, PERF did not have much time to make additional changes. PERF is asking the SBOA to complete the next fiscal year's audit by October 28, 2005, so that PERF will have more time to understand and work on the issues raised by the audit.

One-third of the SBOA's findings in last year's audit related to benefit over- and under-payments. Many of the incorrect payment amounts are tied to problems in accurately determining members' creditable service. PERF is studying the computation of creditable service and has developed a template that it plans to make available to all employers. Ball State University, Purdue University, and the City of Indianapolis are participating in a pilot program using the template.

PERF is also reengineering the retirement process. For 86% of PERF's membership, Social Security is a member's only other resource, making the prompt determination and delivery of a PERF benefit crucial. PERF is working to reduce the time to process a member's benefit application and is focusing on minimizing the time between a member's retirement date and the first payment of a retirement benefit. PERF is also trying to be honest with members as to how long the application process takes.

#### (4) Bridge to Retirement Program

To assist future retirees with planning for retirement, PERF is developing Web-based account access and self-service capability for members to make changes to their accounts. PERF is also introducing a program called Bridge to Retirement to educate and aid members in the transition from work to retirement (Exhibit 2). For example, 14% of PERF members apply for a retirement benefit within one month of their retirement date, although it currently takes PERF in excess of 130 days to process a retirement application. Bridge to Retirement asks the questions that members should consider before retirement and suggests a twenty-four month process to a member's retirement date. PERF is also changing attitudes across every process and department within PERF and educating employers on how best to make the system work for PERF members.

#### (5) PERF Scorecard

To measure its progress, PERF has created a scorecard that includes targets for both statewide initiatives and agency metrics. For example, the target for average number of days to complete the retirement application process is 58 (actual is 139). The target average number of days from retirement date to first check is 30 (actual is 118). The target for customer satisfaction is 98% (actual is 59%).

Fundamental agency change initiatives include the resolution of SBOA findings, creditable service computation, self-service capabilities, and Human Resource development. PERF is also working on implementing a 2003 requirement to furnish an annual account statement to members and beneficiaries who receive their benefit by direct deposit.

Representative Burton asked about the extent of benefit over-/under-payments. Currently, 20% of all payments are off somewhat, usually not by a large amount.

Representative Kromkowski inquired as to the reasons that the average number of days from retirement date to first check is 118. Mr. Adams responded that there are three primary reasons. The first is that the retirement application does not include all of the necessary supporting documentation, such as the birth certificates of the member and beneficiaries. The second is problems with the creditable service calculation. For example, there may be a question as to the exact dates of a member's leave of absence. PERF looks to employers to provide that information, but an employer's records may not be readily available or in a usable form. The third reason is a delay in PERF's receipt of a certification from an employer as to a member's last day of employment and final pay. With a 139 day average to complete the retirement application process, PERF's customers don't understand the process or have unrealistic expectations. PERF has a lot of work to do to streamline the application process. PERF is starting to make initial payments without a member's final information and "trueing up" the benefit later.

In response to a question from Senator Craycraft, Mr. Adams stated that a retirement application also includes employer information. PERF has work to do to educate employers about the retirement process. Some employees don't know that they have a defined benefit retirement plan. PERF plans to launch a program next spring to send to each member an annual statement that contains information similar to that shown in Social Security's annual statement, such as how much creditable service PERF has recorded for the member and an estimated benefit. Mr. Adams assured the Commission that any online account access would be both secure and protected.

Senator Young asked whether members who had received overpayments were aware of their tax liability. Mr. Adams replied that members were not yet aware that any tax liability

is a member's responsibility. He said that PERF generally will handle any overpayment as a one-time adjustment to a member's benefit, although PERF's recovery of the overpayments will be through a humane process that causes the least amount of hardship. All of the overpayments resulted from PERF's 2002 computer upgrade and are not large amounts. Mr. Adams observed that PERF cannot "write off" overpayments.

PERF is researching adding more investment options for the annuity savings accounts. One possibility is a lifestyle fund that will allocate a greater amount of the member's contributions to equities when a member is younger and gradually shift to fixed income as a member gets closer to retirement. Mr. Adams pointed out that a majority of members currently have their annuity savings accounts in the Guaranteed Fund.

Senator Craycraft urged PERF not to take more than 50% of the net amount of a member's benefit each month for repayment.

Mr. White asked about PERF's progress on implementing internal controls in response to the SBOA's qualified opinion. Mr. Adams responded that PERF's first priority is balancing its books on a monthly basis and that he will have a better answer to this question after the SBOA's next audit, which started July 1, 2005, and Mr. Adams hopes is completed by October 28, 2005.

In response to a question by Representative Burton, Mr. Adams responded that PERF wants to establish a customer focus in everything that PERF does and in every communication that PERF has with a customer. PERF currently is focused on process. PERF expects to roll out the new customer information program beginning December 1, 2005. Indiana University, PERF's second largest employer, wants to conduct retirement counseling for its employees using PERF's materials. Mr. Adams also mentioned that PERF has a retirement workshop for State employees going on today, but it was not well publicized.

## (B) Proposed Legislative Changes

### (1) Release of Social Security Numbers

Chris Ruhl, Policy Director and General Counsel to the Office of Management and Budget, presented PERF's proposed legislative changes (Exhibit 3). The first request is to amend IC 4-1-10-5 to permit the release of Social Security numbers for the purpose of administration of a state retirement fund. Under IC 4-1-10, which became effective July 1, 2005, PERF and the Indiana State Teachers' Retirement Fund (TRF) may release only the last four digits of a member's Social Security number, unless one of the following exceptions applies: disclosure is to a federal, state, or local agency; disclosure is expressly required by federal law, state law, or a court order; or the member expressly consents to the disclosure in writing. IC 4-1-10 prohibits the release of Social Security numbers to third party vendors used to administer the funds. The amendment should apply to both PERF and TRF. PERF encourages the Commission to think about the application of IC 4-1-10 to the state's deferred compensation plan as well.

Senator Young asked the reason that the amendment is needed. PERF needs to be able to release Social Security numbers to have 1099Rs printed and for other administrative purposes.

### (2) Confidentiality of Certain Information concerning Alternative Investments

PERF's second request is to add a new section, IC 5-14-3-4(b)(22), to permit PERF to

maintain the confidentiality of certain alternative investment information. The type of alternative investment information that investors generally regard as confidential includes portfolio company information or key investment priorities that could reveal a general partner's strategy and tactics to competitors. Certain information would remain public, including the name and address of the alternative investment contact, the dollar amount of PERF's commitment, the return rates, and the fees and costs.

Many states are considering or have already enacted legislation to protect alternative investment information. Without specific confidentiality provisions, many private equity funds are growing more reluctant to have public pension funds as investors. This result could harm PERF by limiting its alternative investment opportunities, and as a result, negatively affect PERF's investment performance and overall investment strategy.

Mr. White asked for a definition of alternative investments. Mr. Adams listed hedge funds, real estate investment trusts, distressed businesses, and buyouts as examples of the types of alternative investments PERF means. For a particular provider, PERF will have information about the investment strategy, the types of investment vehicles used, the history and style of the management team, and how investment decisions are made, but will not know the specific investments a provider makes.

### (3) Review by the 1977 Fund of Default Class 1 Impairments

PERF's third request is to clarify the disability process for the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund). Currently, 1977 Fund disability claims must first be submitted to the local pension board. If the local board does not take timely action on a 1977 Fund disability claim, a Class 1 disability is automatically awarded without the possibility of review by the 1977 Fund. This default process can produce unfair results and windfall awards from the 1977 Fund solely because of a delay that is outside of the 1977 Fund's control. The proposed change would provide for oversight of a default award by the 1977 Fund.

### (C) Report concerning the Legislators' Defined Contribution Plan Pilot Program

Mr. Adams described the features of the pilot program that was initiated on January 1, 2004, using a third-party record keeper, Great Western (Exhibit 4). The scope of the pilot program was limited to legislators, or approximately 300 accounts. The investment choices included S&P 500, International, Small Cap, Money Market, and Bond Fund, with the CRIF being the default choice. No guaranteed option was available.

The primary purpose of the pilot program was to provide legislators with the ability to change investment decisions more frequently than quarterly. Under the pilot program, legislators can change their investment selections as often as they desire. The pilot program also provides self-service capabilities, such as the ability to view accounts, make transactions, and update information online or through automated phone support. While most participants wanted the ability to change investment selections more often than quarterly, they did not want or need daily valuations of their accounts.

Mr. Adams shared some observations about the pilot program. Most participants are not viewing or changing their accounts online. Many participants have not made any changes to their accounts. In response to a survey that PERF conducted, most participants viewed the ability to change their accounts as a very positive capability and one that is necessary. The vast majority of participants are not "day traders", however.

The pilot program experienced challenges as the result of the change in service level from

Tom Parker of the PERF staff to a third-party provider, Great Western. PERF and Great Western deliver services differently, and customers were not getting the same level of service with Great Western.

Mr. Adams discussed the challenges involved in expanding the pilot program from 300 legislator participants to 180,000 PERF participants. These include data and administrative requirements, especially those involved in the relationship between the defined benefit and the defined contribution attributes of PERF. A majority of PERF's current participants are in the Guaranteed Fund, so don't make investment selections, and a majority of PERF retirees are not online. Another challenge involves the level of customer service to be offered. Yet another concern is the number of employers involved in remitting employee contributions every two weeks. PERF has 1,100 employers with a variety of payroll systems versus one employer, the State of Indiana, for the legislators.

PERF currently recognizes investment gains and losses once per quarter. Changes in the PERF statutes during the legislature's 2005 session authorize the adoption of policies to allow for more frequent valuation and faster investment of employee contributions. However, Mr. Adams pointed out that quarterly account investment and valuation does help to keep the costs of the fund low. The current pilot program represents over 50% of PERF's information technology budget.

In response to a question from Senator Young, Mr. Adams explained that there are primarily two ways to assess account fees. One method bases the fee on the dollars under management. The other method assesses a fee on a per account basis. PERF is looking at various record keepers and fee structures. Great Western currently charges an annual fee of \$50 per account for the pilot program.

Representative Burton asked for more information concerning complaints about the pilot program. Mr. Adams explained that PERF doesn't always hear about complaints that are made to Great Western. That's why PERF surveyed pilot program participants. The complaints listed in the survey revolved around the level of service provided by Great Western versus the level of service provided by Tom Parker. As a result, PERF is considering whether PERF should resume providing customer service for the pilot program and allow a third party to handle the technical aspects of the program.

### **3. Presentation by the Indiana State Teachers' Retirement Fund (TRF)**

#### **(A) 2005 TRF Update**

Robert Newland, TRF Acting Executive Director, briefly reported on Dr. Christopher's retirement as TRF's executive director and TRF's search for a new executive director. He stated that he was not a candidate for permanent appointment as the executive director.

#### **(B) Proposed Legislative Changes**

Tom Davidson, TRF's General Counsel, presented TRF's proposed legislative changes (Exhibit 5). He noted that PERF's legislative proposals concerning the release of Social Security numbers and the confidentiality of certain information concerning alternative investments would also apply to TRF.

##### **(1) Retirement by a TRF Member with Service as an Elected Official**

TRF requested an amendment to IC 5-10.2-4-8.2 to permit a member of TRF who has also served as an elected official to choose at the member's retirement date whether to

retire from TRF or PERF. Although IC 5-10.2-4-8.2 has not in the past been interpreted to require that TRF members in this situation be retired from PERF, PERF recently made this argument. The proposed change would continue TRF's past practice of allowing the retiree to make the choice. The term "elected official" includes any state or political subdivision elected position, except for the General Assembly which is already covered by another provision (IC 5-10.2-2-8(b)). TRF members to whom this amendment would apply usually hold positions as county commissioners or city councilmen.

In response to questions by Senator Craycraft and Representative Burton, Mr. Davidson explained the interplay between statutes that apply to a retired member of PERF or TRF who is reemployed in another covered position. Sometimes a member in this situation earns a second benefit; sometimes the member earns a supplemental benefit. Whether a member has an earnings limitation in the reemployment position depends upon the member's age and whether a member is separated from employment more than 90 days before taking the second position. At age 70, a retired member of TRF who is also an elected official can receive a retirement benefit from TRF and also earn a second benefit from PERF.

Some of the factors that may influence a member's choice as to whether to retire from PERF or TRF include TRF's provision of retiree health insurance and different rates of return for each fund's Guaranteed Fund.

Senator Craycraft asked why couldn't a teacher be treated the same as a police officer or firefighter who can retire, receive a pension, and be reemployed in another position without any limitation on earnings or type of job. Mr. Davidson replied that this would require a change in the law.

Senator Young asked whether a teacher could retire and still be a teacher. He thinks that the wording of the amendment proposed by TRF would allow that. Mr. Davidson agreed to review the wording of the proposed amendment.

## (2) Eligibility for Survivor Benefits

TRF requested an amendment to IC 5-10.2-3-8(a)(3) to specify the type of disability benefit that a member must be eligible to receive in order for a member's surviving spouse to qualify for a survivor benefit from TRF. The TRF Board of Trustees recommended that TRF ask for this clarification after the issue was brought to the Board's attention.

TRF has two types of disability benefits: classroom disability and regular disability. When a teacher cannot teach in a classroom, but can perform other duties, the teacher does not qualify for Social Security disability or regular TRF disability retirement under IC 5-10.2-4-6. However, the member is entitled to a classroom disability benefit under IC 21-6.1-5-1. Classroom disability does not include survivor benefits and also requires that the amount paid to the member as benefits be repaid out of the member's annuity savings account.

If the term "disability benefits" in IC 5-10.2-3-8(a)(3) is interpreted to include classroom disability under IC 21-6.1-5-1, a survivor of a member on classroom disability would not be entitled to survivor benefits and likely would not receive a distribution as a designated beneficiary from the member's annuity savings account after the classroom disability benefits that the member had received were repaid from that account.

If the term is interpreted to mean only a disability retirement under IC 5-10.2-4-6, then a survivor of a member on classroom disability who was also eligible for regular disability



(but had not applied for it) would be entitled to survivor benefits after most or all of the member's annuity savings account is used to repay the classroom disability benefits that the member received.

Representative Burton asked about the fiscal impact of this change. Mr. Davidson responded that the change should not have a fiscal impact, because TRF is already interpreting the statute this way.

### (3) Military Service Credit

TRF requested an amendment to IC 21-6.1-4-6.1 to prohibit the use of military service to obtain creditable service in TRF if the military service is used to qualify an individual for a benefit from a military retirement plan. This issue comes up a couple of times each year.

Since 1945, the legislature has provided teachers with a very generous military service credit. A TRF member who receives an honorable discharge and returns to teaching or approved college teacher training within 18 months after completion of active military service is entitled to an award of creditable service in TRF equal to the length of the member's active military service or six years, whichever is less. The award is not subject to the one-seventh rule under IC 21-6.1-4-5. Unlike other military service credited or purchased elsewhere in the Indiana Code, IC 21-6.1-4-6.1 does not limit TRF's use of military service already being used in the military pension system to qualify for a benefit.

In response to questions by Senator Young and Senator Craycraft, Mr. Davidson provided examples as to how the military service credit is used in a member's retirement benefit calculation. In response to a question from Representative Kromkowski, staff explained that the military service credit provision was not limited to World War II military service.

Staff asked how many TRF members would be affected by this change. Mr. Davidson did not have this information but thought that he could obtain it.

## **4. The Next Meeting Date**

Senator Harrison scheduled the Commission's next meeting on Wednesday, September 28, 2005, at 10:00 a.m. He requested that staff prepare for the Commission's review proposed legislation based on today's testimony.

## **5. Adjournment**

Senator Harrison adjourned the meeting at 11:50 a.m.